



OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Lease Cost Saving Opportunities – Eastern Area

White Paper

Report Number
SM-WP-15-002

May 12, 2015



THIS AGREEMENT MADE this
BETWEEN:

(Name)

after called the LESSOR

Office Box where applicable)



OFFICE OF INSPECTOR GENERAL

UNITED STATES POSTAL SERVICE

Executive Summary

The U.S. Postal Service leases more than 23,000 buildings, consisting of about 79 million interior square feet. It pays more than \$800 million annually to lease these properties.

The U.S. Postal Service leases more than 23,000 buildings, consisting of about 79 million interior square feet. It pays more than \$800 million annually to lease these properties. The Eastern Area has 10 districts covering parts of New York and extending as far south as Tennessee. As of September 2014, the Eastern Area leased more than 4,500 buildings, with annual lease costs of over \$111 million.

The Postal Service Facilities organization typically begins the lease renewal process by providing area officials a report of leases expiring within the next 24 to 36 months. Depending on the lease value, area officials will take action to renew or terminate the lease. Prior to renewing a lease, the Facilities organization completes an analysis of the lease value or a real estate appraisal. Property management activities, such as maintenance and repairs, must also be considered when evaluating lease rates.

During fiscal year 2014, the U.S. Postal Service Office of Inspector General developed a predictive risk model to analyze Postal Service properties. The model analyzes whether the Postal Service is renewing leases at a fair price and whether it needs the leased space that is due for renewal. This paper highlights potential cost saving opportunities relating to the buildings the Postal Service leases in the Eastern Area.

Leased Building Overview

The Eastern Area has 10 districts covering parts of New York and extending as far south as Tennessee.

Leased Buildings	4,594
Interior Square Footage	11.9 million
Annual Lease Cost	\$111 million
Potential Lease Cost Savings	\$2.2 million annually

The Eastern Area could save more than \$2.2 million annually in lease costs relating to 77 leases that are due to expire over the next 2 years.¹ The predicted local market lease rates for these facilities are lower than the Postal Service’s current lease rate. Each of these facilities has potential lease cost savings of at least \$5,000 annually.² While there is no single substitute for factors such as location, relocation costs, and building condition when assessing a new or existing lease, the Postal Service could benefit by using forecasted lease rate information, in conjunction with other assessment activities, when renewing its leases.

¹ The 77 leases will expire on various dates from May 31, 2015, through March 31, 2017.

² Additional facilities have potential cost savings totaling less than \$5,000 annually. Our analysis focused on those leases with the highest potential for cost savings.

Transmittal Letter



OFFICE OF INSPECTOR GENERAL
UNITED STATES POSTAL SERVICE

May 12, 2015

MEMORANDUM FOR: JOSHUA D. COLIN, PhD.
VICE PRESIDENT, EASTERN AREA OPERATIONS

TOM SAMRA
VICE PRESIDENT, FACILITIES

E-Signed by Keshia L. Trafton
VERIFY authenticity with Sign Desktop

FROM: *for*
John E. Cihota
Deputy Assistant Inspector General
for Finance and Supply Management

SUBJECT: Draft White Paper – Lease Cost Saving Opportunities –
Eastern Area (Report Number SM-WP-15-002)

Attached are the results of our review of Lease Cost Saving Opportunities – Eastern Area (Project Number 15BG012SM000). Our objective was to present opportunities for lease cost savings in the Eastern Area.

We appreciate the cooperation and courtesies provided by your staff. If you have any questions or need additional information, please contact Keshia L. Trafton, director, Supply Management and Facilities, or me at 703-248-2100. Thank you in advance for your time and consideration.

Attachment

cc: Corporate Audit and Response Management

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Observations

In FY 2014, the Postal Service conducted more than 5,000 lease activities, which included alternate quarters, new leases, extensions, and renewals.

Introduction

This report presents opportunities for lease cost savings in the U.S. Postal Service's Eastern Area (Project Number 15BG012SM000). The Postal Service leases more than 23,000 buildings, consisting of about 79 million interior square feet. It pays more than \$800 million annually to lease these properties. This amount does not include maintenance, repairs, alterations, or other costs relating to the properties. The Eastern Area has 10 districts covering parts of New York and extending as far south as Tennessee. See Figure 1 for a map of the districts in the Eastern Area. As of September 2014, the Eastern Area leased more than 4,500 facilities, with annual lease costs over \$111 million. This report highlights potential cost saving opportunities relating to buildings the Postal Service leases in the Eastern Area.

Figure 1. Map of Eastern Area Districts



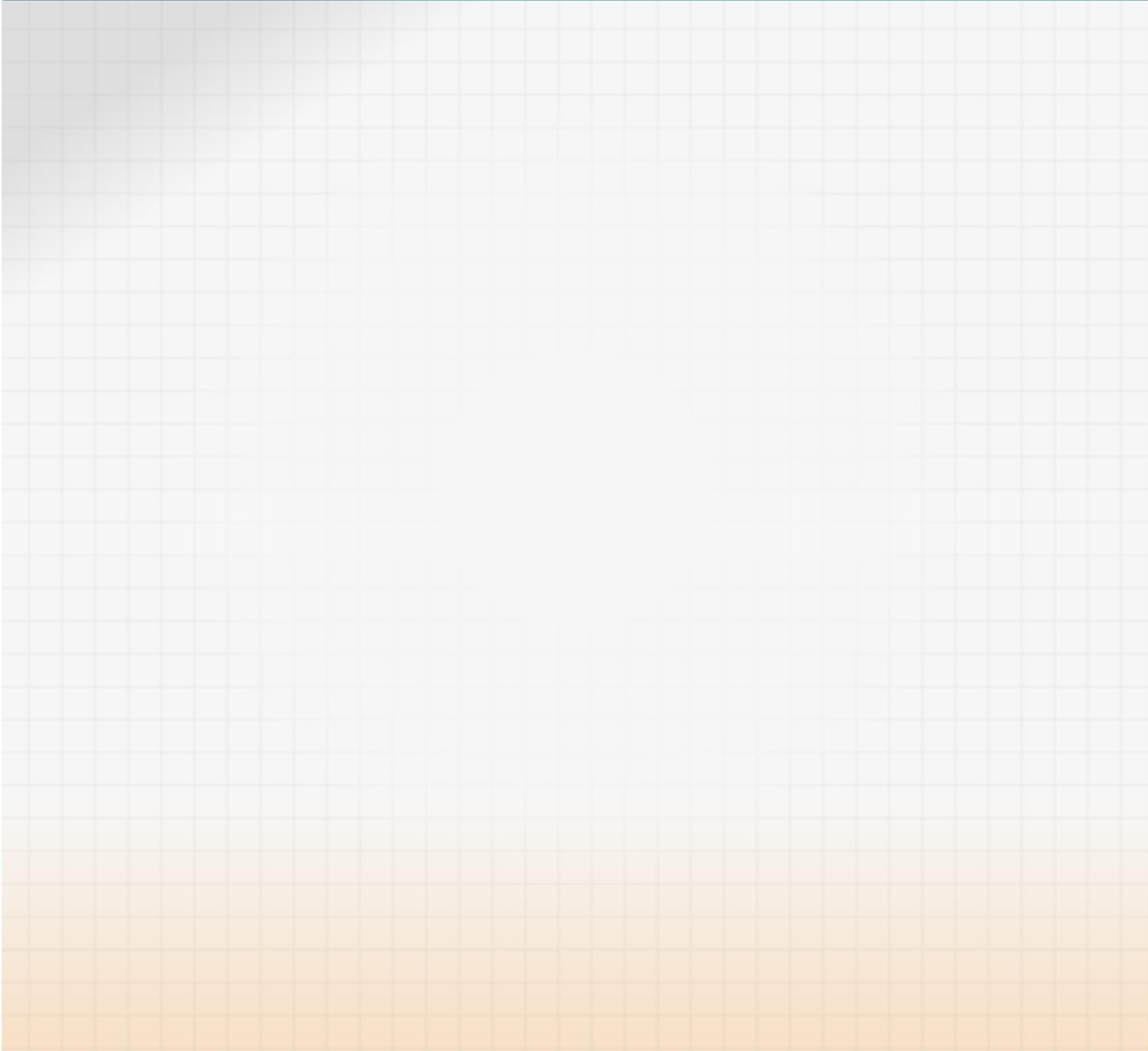
Source: Postal Service intranet site.

The Postal Service Facilities organization seeks to optimize the facility footprint and provide appropriate locations for postal needs, including retail service and network and delivery operations. In fiscal year (FY) 2014, the Postal Service conducted more than 5,000 lease activities, which included alternate quarters, new leases, extensions, and renewals.

The Postal Service Facilities organization typically begins the lease renewal process by providing area officials a report of leases expiring within the next 24 to 36 months. Depending on the lease value, area officials will take appropriate actions to renew or terminate the lease. An analysis of lease values or an appraisal is performed before every lease of real property. In addition, property management activities, such as maintenance and repairs, must be considered when evaluating rental rates.

During FY 2014, the U.S. Postal Service of Inspector General (OIG) developed a predictive risk model, the Facilities Risk Model, to analyze Postal Service properties. With regard to leased properties, the Facilities Risk Model analyzes whether the Postal Service is renewing leases at a fair price, ranks the facilities based on how the Postal Service's lease rent compared to forecasted market rates, and analyzes whether the agency needs the leased space that is due for renewal. The model uses real estate market data to conservatively identify locations that warrant further consideration during the lease evaluation process or as part of an optimization study.

Number of Facilities by District with Potential Annual Savings of \$5,000+



We analyzed Facilities Risk Model data for leases expiring between April 2015 and March 2017 in the Eastern Area to identify opportunities for management to reduce lease costs. We included only those leases that had a potential for more than \$5,000 in annual savings. We obtained real estate data from the Postal Service’s electronic Facilities Management System (eFMS)³ and nationwide extracts from a real estate company.⁴

To perform our analysis, we:

- Identified about 1,900 leases in the Eastern Area due to expire from April 1, 2015, through March 31, 2017.
- Determined each facility’s current lease rate by interior square footage.
- Calculated the difference between the facility’s current lease rate by interior square foot and projected lease rate per square foot.

Opportunities for Lease Cost Savings

The Eastern Area could potentially realize annual lease cost savings of \$2,178,799 for 77 facility leases expiring between April 2015 and March 2017, or \$4,101,699 over 2 years.⁵ See Table 1 for a breakdown of the facilities by district. The annual lease cost for each of these facilities is at least \$5,000 higher than the forecasted market rate.

Table 1. Facilities by District With Potential Annual Savings of \$5,000 or More

District	Number of Facilities
Appalachian	6
Central Pennsylvania	4
Kentuckiana	2
Northern Ohio	7
Ohio Valley	6
Philadelphia Metropolitan	10
South Jersey	11
Tennessee	8
Western New York	15
Western Pennsylvania	8
Total	77

Source: OIG Analysis of Facilities Risk Model Data.

In order to receive the best value for its leases, the Postal Service must formally determine the value of expiring leases and, whenever possible, ensure negotiated leases are supported by current market data.⁶ Currently, the Postal Service uses the 3-digit ZIP Code Report to identify recently negotiated rates for postal facilities within a defined 3-digit ZIP Code. We believe management can use additional market lease information to enhance their decision making analysis when renegotiating the

³ eFMS is the official Postal Service record for real property inventory and the management system for administering all property-related projects, including acquisition, design, construction, disposal, repairs, health and safety mitigation, and property inspections. In addition, eFMS manages all aspects of the Postal Service’s property leasing program, including the preparation of leases, making tax payments, and outleasing/subleasing excess space.

⁴ External real estate data was obtained from CoStar Realty Information, Inc., (CoStar) a commercial real estate information company.

⁵ We claimed a total of \$4,101,699, which represents cost savings for the first 2 years of the new leases.

⁶ For those leases with annual rents exceeding \$10,000.

The Postal Service can potentially save about \$2.2 million in annual rents for facilities in the Eastern Area with leases that will expire by March 2017.

expiring leases to fair market rates, considering alternate lease locations, or conducting optimization studies. By including additional data in its analysis, the Postal Service could strengthen its valuation process.

Expanding market analysis to include forecasted market rates rather than current rates, and data on similar property types, not just postal facilities, will support negotiations and decision making. This additional analysis could also be beneficial when evaluating facilities with annual rent in excess of \$50,000, where the Postal Service considers comparable rents to be the best justification for the proposed rent.⁷

There are other items to consider when determining lease value, such as:

- Location.
- Community relations.
- Traffic patterns.
- Relocation.
- Building alteration costs when assessing whether to move to a new facility.

We recognize that no single tool or step addresses every factor that must be weighed when taking leasing actions; however, by incorporating additional lease rate information in its analysis, the facilities organization can complement the leasing process and provide critical insights for making informed and cost effective leasing decisions. This includes renegotiating above-market lease rates to lower rates in the Eastern Area and further target resources to determine facility optimization.

Conclusion

The Postal Service can potentially save about \$2.2 million in annual rents for facilities in the Eastern Area with leases that will expire by March 2017. Using forecasted lease rate information, we identified 77 facilities that have a potential lease cost savings of at least \$5,000 annually. Predictive data analysis enhances informed decision making. The Postal Service should use forecasted lease rate information as a supplemental tool when evaluating expiring leases to gain insights into potential lease rate savings or other building lease considerations where appropriate.

We discussed our results and monetary impact with management and included their comments were appropriate. Management disagreed with both the methodology of the analysis and the monetary impact. Management stated the methodology for establishing the forecasted rate is seriously flawed because the analysis is based on an average of all submarket properties taken from CoStar within a 5-digit ZIP Code area, without any consideration for size or adjustments that are required in establishing an accurate market rental rate. They further stated that considering comparable properties, building condition, and lease terms are needed when establishing market rates. Lastly, management stated it expressed its disagreement with our analysis of potential lease cost savings in a prior OIG report and continues to disagree with the OIG's Facility Risk Model lease data; therefore, management would like to hire an outside consultant to review the methodology and accuracy of the model.

⁷ For leases over \$50,000, the manager, Property Management, Facilities Service Office, may accept methods other than comparable rents to support the rental value. Leases with an annual rent over \$150,000 require a contract appraisal.

We continue to believe that the Postal Service could enhance its leased renewal process by incorporating additional data analysis when determining market rates. As previously indicated in this white paper, the Postal Service currently uses data that identifies recently negotiated rates for postal facilities within a defined 3-digit ZIP Code. The 5-digit ZIP Code analysis provides more detailed information not included in the 3-digit ZIP Code Report, such as forecasted market rates and data on similar property types, not just Postal Service facilities.

We agree with management that there are several factors to consider with evaluating leased facilities, and the analysis presented in this paper is not intended to be a substitute for any current policies and procedures. However, the analysis is an additional tool to consider when the Postal Service is targeting its limited resources to research and negotiate leases.

We attempted to collaborate with Facilities management to further refine the Facilities Risk Model, and based on management's comments from our prior report, we revised the model to include confidence levels that account for the level of comparable information available, such as submarket, state, and national data. The model also incorporates more facilities with characteristics similar to Postal Service buildings. We welcome continued collaboration with them to further enhance the Facilities Risk Model.



OFFICE OF
**INSPECTOR
GENERAL**
UNITED STATES POSTAL SERVICE

U.S. Postal Service Office of Inspector General
1735 N. Lynn Street
Arlington, VA 22209

Telephone: 703-248-2100
www.uspsoig.gov

For media inquiries, contact Agapi Doulaveris
Telephone: 703-248-2286
adoulaveris@uspsoig.gov